

WHEN WORLDS COLLIDE

Sometimes it is difficult to separate commercial from legal advice.

Solicitors' duties sit in grey territory when it comes to the commercial wisdom of whether a client ought to proceed with a transaction.

What extra steps does the solicitor have to take to avoid liability in the context of legal advice that intersects with financial considerations? The answer depends, to a large extent, on the type of client and the circumstances of the retainer.

Generally, solicitors resist giving financial advice because that is the role of financial advisers and the LPLC policy excludes cover for licensed financial services. However, as a recent case demonstrates, making a referral to a financial adviser at the start of the matter alone is not always sufficient to discharge the solicitor's liability.

In this case, a solicitor was found liable in relation to an improvident investment made by the client, even though he had told the client in writing at the commencement of the retainer that he was not advising on the financial viability of the project.

The facts

The case concerns the client losing a \$350,000 investment in a residential development being run by an old school friend. In return for a \$350,000 advance, the development company proposed to pay him 10 per cent per annum on the advance and 20 per cent of net profits on completion. This would be a tidy profit.

The client instructed his solicitor to advise on the terms of the proposed investment agreement between the parties which had been styled as a joint venture. When presented with the deal, the client's solicitor outlined his concerns. For example, he was worried that his client's only security was to be a shareholding in the development company and that the agreement left the door open for a dilution of that shareholding.

Given the insufficient equity in the development property to use as security, the client's solicitor sought security over other real property. Another development already built and partly sold by a second special purpose company (C2) controlled by the developers was suggested as an alternative.

The solicitor conducted title searches and an ASIC search, revealing that C2 was not in liquidation.

In the days leading up to the agreement being signed, the investor client expressed his misgivings. He was finally won over when the developers confirmed, at the sign-up meeting in the presence of the solicitor, that there was \$4 million equity in C2 to rely on as security. The solicitor did not recommend that this should be independently verified before the client signed up. The solicitor had no way of knowing, without further investigation, whether the representation was true.

The security was not a charge on the assets of C2 but a right to obtain a transfer of shares in C2 in the event of default. Executed share transfers were provided, to be held in escrow pending default. The parties signed up.

The fall-out

About two years later, the investor client was confronted with a mortgagee auction billboard at the development site. The next blow was to discover that C2 was in voluntary liquidation and its shares were worthless.

The court noted that in some cases there may be no bright line of distinction between legal and commercial advice where a solicitor is acting for a client in a proposed commercial transaction. In this case the solicitor had breached a contractual duty, so the court did not have to explore the parameters of "penumbral" duties in tort much debated in recent case law.

Lessons

The contractual retainer is one useful guide for how far solicitors need to dispense "commercial" advice on the merits of a client proceeding.

The solicitor's overarching role to protect the client's interests is another reliable guide. Whether or not a client is commercially sophisticated, they may rely on the solicitor to address commercial practicalities. Clearly, vulnerable or inexperienced clients require special attention.

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Findings

The court found a breach of retainer by the solicitor because of the inadequate security provided. The solicitor didn't know and hadn't inquired whether share certificates had been issued and where they were.

He had not warned that even if the client became a shareholder in the company, he would rank last in any liquidation. And he had not ensured there was a clause preventing dilution of shares or further mortgages or charges.

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The best risk management approach is to be circumspect, acknowledging the overlapping territory between legal and financial considerations and addressing it.

Identify financial issues which may affect the soundness of your legal advice (e.g. the value of a security or lender client's incapacity to service repayments).

Always recommend that the client consult a specialist for financial advice and give the client time to obtain this advice. Keep a written record of your advice and the client's response. ●

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